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No. 82-628

In the Supreme Court of the United States

OCTOBER TERM, 1982

ENERGY RESERVES GROUP, INC., ET AL.,
Petitioners,

VS.

JAMES B. EDWARDS,
SECRETARY OF ENERGY, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the Temporary Emergency Court of Appeals

BRIEF OF THE STATES OF OKLAHOMA AND WYOMING AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE

The State of Oklahoma is acutely interested in the basic question presented to this Court by the Petition for Writ of Certiorari filed herein, *i.e.*, whether injection wells may be excluded in the determination of an oil property's qualification for the stripper exemption.[1] Oklahoma has enacted a "Gross Production Tax" of "seven percent (7%)

[1] The stripper exemptions are found in the Trans-Alaska Pipeline Authorization Act, Pub.L. No. 93-153, §406, 87 Stat. 584 (1973); The Emergency Petroleum Allocation Act, Pub.L. No. 93-159, §4, 87 Stat. 628 (1973); and the Energy Conservation and Production Act, Pub.L. No. 94-385, §121, 90 Stat. 1125 (1976).

of the gross value of the production of petroleum" within the State. Title 68 O.S. 1981, §1001(b). The amount of tax revenue available for public purposes would be increased or decreased, respectively by the monetary of oil produced within the State. The revenue generated by the gross production tax is used by Oklahoma not only for general revenue fund purposes, but also fund(s) portions of the tax to finance the county highway fund and the local school districts fund(s). Title 68 O.S. 1981, §1004, §1004a. Thus, the State of Oklahoma and each of its citizens have a direct interest in the question before the Court.

The State also has enacted a "Petroleum Excise Tax" of "eighty-five one thousandths of one percent (.085 of 1%) of the gross value on each and every barrel of petroleum oil produced in the State of Oklahoma which is subject to gross production tax." Title 68 O.S. 1981, §1101. Revenues generated by this tax are used to defray expenses of the Conservation Department and the Interstate Oil Compact Fund of Oklahoma. Title 68 O.S. 1981, §1103. Thus, the revenue generated by oil production within the State of Oklahoma provides funds for the continued conservation of the State's natural resources, especially crude oil, and the prevention of physical and economic waste of that vital resource. Title 52 O.S. 1969, §86.2.

Oklahoma is one of the leading petroleum producing states of the nation, and much of the oil production involved in this litigation was produced in Oklahoma. Although precise figures are unavailable, it is conservatively estimated that at least $200 million of the escrowed funds in this case are attributable to Oklahoma production. Therefore, the State of Oklahoma has a direct financial

stake in this litigation of at least $16 million in tax revenues which it will lose unless the Court of Appeals' decision is reversed.

More importantly, however, the State of Oklahoma is deeply concerned by the implications of the Court of Appeals' decision upon its comprehensive regulatory scheme of oil conservation. The decision of the Court of Appeals runs directly counter to conservation practices in the State of Oklahoma which have existed for many years; practices which recognize the absolute necessity of injection wells in waterflood projects and which accordingly give properties with such wells an incentive so as to encourage the maximum recovery of crude oil from the producing reservoirs.

Finally, the decision rests in large part on the Court of Appeals' fear that the counting of injection wells could somehow lead to "abuse". This speculation is merely a red herring, ignoring the comprehensive regulatory scheme which exists in Oklahoma, and all other significant oil producing states, that prevents the very abuse about which the lower court speculated. To allow the decision to stand would implicitly impugn the ability of Oklahoma, as in all other significant oil producing states, to adequately regulate the use of injection wells within the state.

SUMMARY OF ARGUMENT

The Court of Appeals has held that the Department of Energy (DOE) correctly implemented the statutory stripper exemption by excluding injection wells in the determination of an oil producing property's qualification for the exemption. Although the lower court recognized that the primary goal of the exemption was to avoid the premature abandonment of marginal oil wells, thus conserving the nation's domestic oil resources, it raised the spectre of potential "abuse" as a major justification for validating the agency's decision to exclude injection wells in determining a property's qualification for the exemption.

For years the State of Oklahoma has recognized the importance of injection wells in the secondary recovery production of oil by assigning to each injection well an allowable of 45 barrels per day, the same as any other well in the waterflood project. The rationale behind the assignment of an allowable to an injection well is the recognition by the State that by allowing such an incentive the maximum amount of oil can be recovered during a waterflood operation. By the encouragement of secondary recovery operations the state policy engenders conservation of this vital natural resource and the prevention of economic and physical waste. When Congress initially passed the stripper exemption, it *specifically directed* the DOE or its predecessor agencies to take into account state conservation practices in adopting regulations implementing the stripper exemption. One of the primary conservation practices in the State of Oklahoma with regard to injection wells is the assignment of an allowable as above

described. In the implementation of the regulation the DOE completely ignored state conservation practices which have been in existence for many years and instead adopted a policy which runs directly counter to the state policy and to the policy of other federal agencies.

Finally, the Court of Appeals decision rests in large measure on their unsupported fear that if injection wells were counted in determining a property's qualification for the stripper exemption, a great potential for "abuse" would exist and that somehow this would create a loophole in the stripper exemption. However, this unfounded speculation completely ignored the trial court's findings, supported by voluminous evidence, that the drilling and operation of injection wells in oil producing states are highly regulated by state regulatory authorities. The State of Oklahoma regulates the drilling and operation of injection wells to a very high degree, and the Court's assertion otherwise impugns the ability of Oklahoma to regulate adequately the use of such wells.

ARGUMENT

STATE INTERESTS IN THE CONSERVATION OF NATURAL RESOURCES, ESPECIALLY CRUDE OIL RESERVES AND PRODUCTION, AND EXPLICIT CONGRESSIONAL DIRECTION TO THE DOE TO CONSIDER SUCH INTERESTS, HAVE BEEN IGNORED IN THE IMPLEMENTATION OF THE STRIPPER EXEMPTION.

The Court of Appeals has held that the DOE properly implemented the stripper exemption by excluding injection wells from a property's determination of stripper status. Although the court acknowledged that the "paramount sought after result" of the statutory exemption was continued production from marginal properties (Pet. App. A, at 21a), the court speculated that:

> "Including injection wells in the count could possibly lead to a serious abuse of the purposes of the exemption. A lease operator could be encouraged to convert old abandoned wells or to drill additional injection wells to obtain the benefits of the exemption. . . . Ruling 1974-29 eliminates any potential for such abuse. Perhaps it could be considered an extreme measure but it is not arbitrary or capricious."

Id. at 30a-31a.

The unfounded fear of such "potential abuse" permeates the Court of Appeals decision, completely ignores the trial court's findings directly to the contrary, and undoubtedly influenced its decision to exclude injection wells in determining a property's qualification for the exemption. Further, as Petitioners correctly state, the decision below was manifestly erroneous because the Court of Appeals

indulged in speculation outside the record and ignored the trial court's Findings of Fact in violation of the "clearly erroneous" rule of Appellate Review. *See Zenith Corp.* v. *Hazeltine,* 395 U.S. 100, 123 (1969); *United States* v. *United States Gypsum Co.,* 333 U.S. 364, 395 (1948); Fed.R.Civ.P., Rule 52.

When Congress enacted the first stripper exemption in 1973, it specifically provided:

> "To qualify for the exemption under this section, a lease must be operating at the maximum feasible rate of production and in accord with recognized conservation practices."

Pub.L. 93-153, §406(b), 87 Stat. 584, 590 (1973).

Furthermore, the TAPAA Conference Report, which contains much of the legislative history of the stripper exemption, reveals that Congress expected "the administering agency to utilize state data regarding production volumes" in administering the exemption. H.R. Rep. No. 624, 93d Cong., 1st Sess., *reprinted in* (1973) 2 U.S. Code Cong. & Ad. News 2531, 2532. The DOE totally ignored the "recognized conservation practices" and "state data regarding production volumes" in implementing the statutory exemption.

It is indeed ironic that the Court of Appeals could on the one hand recognize that the stripper exemption was essentially a conservation measure, and on the other hand, could sanction a practice (*i.e.,* the exclusion of injection wells) which runs *directly counter* to the exemption's purpose. The State of Oklahoma, as well as many other oil producing states, has long recognized that in order to conserve crude oil production and reserves, it was in the best

interests of the State to grant allowable incentives to injection wells and thus encourage the maximization of recovery of oil resources.

Since December 17, 1932, Oklahoma has provided an incentive to oil producers to engage in secondary recovery waterflood operations by assigning a production allowable to injection wells. The current regulation on this matter provides as follows:

> "An approved and qualified waterflood project shall be entitled to produce an allowable of forty-five (45) barrels of oil per well per day including producing and injection wells on a project basis upon the acreage developed for waterflooding."

General Rules and Regulations of Oil and Gas Conservation Division of Oklahoma Corporation Commission, §2-240 (c) (3) (hereinafter "OCC Rules and Regs.").

The State of Oklahoma, through the Oil and Gas Conservation Division of the Corporation Commission, regulates the use of injection wells to a high degree. Thus, only upon notice and hearing and a showing that substantial quantities of additional oil can be recovered by the injection of fluid or fluids into the common source of supply will an enhanced recovery (waterflood) project be authorized. OCC Rules and Regs. §2-260. The application for a permit to engage in waterflooding must show, *inter alia:* the location of the injection wells; the casing program for the injection wells; and the type of fluid to be injected, its source, and the amount of fluid to be injected daily. OCC Rules and Regs. §3-301.

Furthermore, each individual injection well is subject to stringent regulations. For example, an injection well

must be completed, equipped, operated, and maintained so as to avoid pollution of fresh water strata and may inject fluids only into those geological formations approved by the Commission. OCC Rules and Regs. §3-112(b). Injection of water must be accomplished through adequate tubing and packers and the wells must be equipped so that the Commission may test the injection pressure at any time. OCC Rules and Regs. §3-112(c). Before an injection well is operated, the casing surrounding the tubing must be pressure tested by the Commission. OCC Rules and Regs. §3-112(d).

A separate application is required for the approval of an injection program. OCC Rules and Regs. §3-113(a). That application must show, *inter alia:* the location of the injection well or wells; a copy of the completion report and electric log if the well has been drilled; a diagram of the well showing its depth, injection intervals, and geological formation to be injected; and casing, tubing, and packer information. OCC Rules and Regs. §3-113(b). Notice of the filing of such an application is published in a newspaper of general circulation in the county where the well is located and if any objections to the injection are filed, a hearing must be held before the Commission. OCC Rules and Regs. §3-113(c) and (d).

In view of the economic and regulatory realities of the drilling and use of injection wells within the State of Oklahoma, as is evidenced by the comprehensive and technical regulatory scheme discussed, it is both legally and factually erroneous that the Court of Appeals premise its decision on the "potential for abuse" of such injection wells. This bold assertion, based upon nothing but the Court of

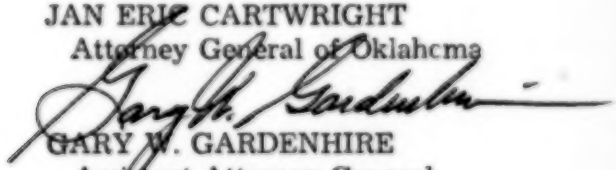
Appeals speculation and made in the face of overwhelming evidence to the contrary, evidences a lack of understanding of the subject matter of the litigation. Furthermore, such an assertion implicitly impugns this State's ability to enforce its own laws and regulations, which are designed to prohibit the drilling of unnecessary injection wells while assuring that the State obtains the maximum recovery of oil from producing reservoirs within its borders.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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